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Transforming the Chinese Economy

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Can China really grow by eight percent every year until 2033?

China's economy has grown by an average of 9.8 percent annually since 1979, and now it is the world's second largest economy**. Justin Lin** of Peking University's National School of Development says China can grow by eight percent per year for the next 20 years, by which time it will surpass the U.S. as the biggest economy in the world, assuming the U.S. grows at two percent a year until 2033.

"Developing countries could use technology transfers from advanced countries to achieve a faster rate of economic growth than the industrial vanguards," said Lin in the keynote address of the recent inaugural SMU China Forum. "If you want to know how long China can sustain this rate of economic growth you need to understand how large the advantage of backwardness still is."

Advantage of backwardness

Lin, who is the former Chief Economist at the World Bank, was referring to the “backwardness” concept postulated by Russian economist Alexander Gerschenkron. Gerschenkron’s theory describes how countries which are less developed vis-a-vis the most developed countries could employ established best practices to develop at a faster rate, and possibly leapfrog the most advanced countries.

China failed in its initial industrialisation plans in the 1950’s and 1960’s because it was trying to compete in areas where it had little comparative advantage i.e. high-tech industries, says Lin. After the country opened up in 1979, it engaged in areas where it had an advantage, which was in low-tech, low-wage industries.

With such industries now moving out of China following the rise in general wage levels, where does that leave China? According to Lin, the answer lies in exploiting China’s remaining advantages of backwardness.

“One way to measure the advantage of backwardness is to see the per capita income gap between a developing country and a high-income country,” Lin explains. “In 2008, per capita income in China as measured in purchasing power parity was 21 percent of U.S. per capita income. That level of per capita income is roughly equivalent to that of Japan’s in 1951, Taiwan in 1975, and Korea in 1977.”

“Annual GDP growth averaged 9.2 percent in Japan from 1951 to 1971, 8.3 percent in Taiwan from 1975 to 1995, and 7.6 percent in South Korea from 1977 to 1997. Based on that, China should be able to grow by about eight percent for another twenty years.”

If that happens, it would represent over 50 years of breakneck economic development. Is Lin being realistic?

"Professor Lin represents one of a number of 'China optimists', a camp of scholars that expects China's heady growth to continue unabated into the long-term future,” says **John Donaldson**, Associate Professor of Political Science at SMU. “Although he's fully aware that corruption and other problems can be barriers to such growth, his extensive research on China's economy and polity gives him confidence that China's leaders can overcome these challenges. Views like these spark further debate amongst scholars, officials, business leaders and other China Hands seeking to understand China's future."

Reforming China

While Lin’s projection of eight percent annual growth over the next 20 years might yet prove correct, much will depend on the reforms that were announced following the third plenum of Communist Party’s 18th Central Committee.

Much attention had been focused on the word “decisive”, referring to the role of the markets in resource allocation where “basic” had been the Chinese s leaders’ word choice for the past decade. Lin points out the most glaring example of the financial sector, among others, of effectively being a monopoly, and how things are already changing.

“Following the lending rate liberalisation, the next step is to liberalise deposit rates,” Lin told Perspectives@SMU. “Some 70 percent or more of China’s GDP comes from Small and Medium Enterprises (SMEs), but the current banking sector is more geared towards the big State-owned Enterprises (SOEs). Therefore, the next step of reform is to develop banking services catered towards SMEs, as well as the development of local and regional banks.”

Since the end of the third plenum, Chinese official media have published details of the political leadership’s intention to give the market the right to price water, natural gas, oil, electricity, transportation and telecommunications in “building a modern market”. However, doubts remain over the country’s ability to cope with the current over-capacity borne of excess credit and investment.

“Regarding excess capacity, China still has opportunities to make even more investments because it is still a middle-income country,” says Lin. “Where there is excess capacity in one industry, there are investment opportunities in other industries. In a high-income country like the U.S., that is not the case. In China, there are still plenty of opportunities to do industrial upgrading which will create demand that will mitigate the excess capacity. So long as China can maintain this kind of growth, the excess capacity won’t be a main threat to the sustainability of growth in China.”

Social Security

Another change announced post-third plenum was for SOEs to contribute 30 percent of their profits to the state by 2020, doubling the current level. The funds will be transferred to social security programmes in an era of yawning income gaps, which are threatening to tear asunder an already stretched social fabric.

“Social security is very important in maintaining social stability and harmony. When China still had a planned economy, everyone received some kind of protection from the government because everyone is either a member of a collective or an employee of the state. When China moved to the market economy, that kind of protection became diminished, and now China is in the process of re-establishing some form of social security system.”